

# CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM STATEMENT OF INVESTMENT POLICY

## FOR MONITORING EXTERNALLY MANAGED PORTFOLIOS ~~MANAGER MONITORING -~~ ~~EXTERNALLY MANAGED~~

~~February 14, 2005~~ March 17, 2008

*This Policy is effective immediately upon adoption and supersedes all previous Manager Monitoring – Externally Managed policies ~~pertaining to external investment manager and currency overly manager monitoring.~~*

### I. PURPOSE

The CalPERS Total Fund Statement of Investment Policy, adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS' overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the objectives, responsibilities and criteria ("the Policy") for ~~Manager Monitoring – Externally Managed Portfolios Program~~ ("the Program"). This Policy applies to external equity and external fixed income managers. It does not apply to External Managers in the Corporate Governance, Risk Managed Absolute Return Strategies, Alternative Investment Management, and Real Estate programs or any other investment made via an investment in a Limited Liability Company or Limited Partnership. The design of this Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this policy assures sufficient flexibility in managing the implementation of investment strategies of external investment manager portfolios.

### II. INTRODUCTION STRATEGIC OBJECTIVE

~~Under the direction of the Board and senior management of the California Public Employees' Retirement System ("the System), the System's Investment Staff ("the Staff") shall manage the implementation of investment strategies of external investment manager portfolios. In order to ensure the investments achieve strategic return and risk objectives, it is necessary to monitor each portfolio for compliance with the criteria that are specific to its particular mandate as well as reflective of the strategic role the portfolio has been selected to fulfill within the investment program.~~

The strategic objective is to monitor each externally managed portfolio to ensure achievement of strategic return and risk objectives.

~~The Staff develops specific guidelines that outline the manager(s)' strategies, portfolio characteristics, authorized investments and markets, benchmarks and performance objectives. These guidelines become part of the contractual agreement with each firm. Managers are given discretion over the selection of individual securities in the portfolio, in accordance with their guidelines, but are expected to invest the System's assets in compliance with the specific guidelines included in their contracts. The Staff shall closely monitor investment managers in order to:~~

~~A. Evaluate whether managers have achieved their stated investment objectives;~~

~~B. Ensure that managers adhere to their specific investment process; and~~

~~C. Assess the impact of any significant investment firm changes, such as staff, client base, or ownership.~~

~~It should be noted that the System does not specifically approve individual transactions in the portfolios or impose restrictions on investing, except for those stated in the manager's contracts and guidelines, or restrictions imposed by law.~~

### III. RESPONSIBILITIES AND DELEGATIONS

~~A. The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the externally managed portion of the System to the Staff through the Delegations of Authority (Delegation Nos. 89-13 and 95-50).~~

~~B.A. The System's CalPERS Investment Staff ("the Staff") is responsible for duties include, but are not limited to, the following:~~

~~1. Developing and recommending the Policy to the Investment Committee.~~

~~2. Developing and maintaining a procedures manual, subject to periodic reviews and updates, outlining Staff operational procedures to be used in implementing this Policy;~~

~~3. Implementing and adhering to the Policy;~~

~~1. Reporting to the Committee at least annually and more if needed about the performance of the Program.~~

~~2. Monitoring and evaluating the External Managers and reporting recommendations, if any, directly to the Committee as needed, but not less than annually.~~

3. Monitoring the implementation of, and compliance with, the Policy. Staff shall report material concerns, problems, material and changes relating to any external manager at the next Committee meeting, or sooner if deemed necessary., and all violations of Guidelines and Policies immediately, and in writing, to the Investment Committee. These Reports made by the Staff to the Investment Committee shall include explanations of the violations and appropriate recommendations for corrective action.

3.4. Recommending action with respect to the External mManager(s) retained to implement the Program, in accordance with the Policy or with respect to changes in the External mManager's contractual guidelines, or regarding any other aspect the Staff considers pertinent.

5. Reporting to the Investment Committee, as needed, about the performance of the Program. The Staff shall report concerns, problems, material changes, and all violations of Guidelines and Policies immediately, and in writing, to the Investment Committee. Reports made by the Staff to the Investment Committee shall include explanations of the violations and appropriate recommendations for corrective action.

B. The General Pension Consultant ("Consultant") shall be is responsible for:  
  
independently mMonitoring and evaluating the External mManagers and for reporting recommendations, if any, directly to the Investment Committee on a quarterly basis, in accordance with the terms of its contract.

C. The External Manager(s) ("External mManager(s)) are is responsible for all aspects of portfolio management as set forth in each External Manager's contract their respective contracts with CalPERS the System and shall fulfill the following duties:

1. Communicate with the Staff as needed regarding investment strategy and investment results.

2. The external managers are expected to mMonitor, analyze, and evaluate performance relative to the agreed upon benchmark.

2.3. Cooperate fully with the CalPERS' Staff, the System's cCustodian and the General Pension Consultant concerning requests for information.

~~B.~~ The General Pension Consultant shall be responsible for independently monitoring and evaluating the managers and for reporting recommendations, if any, directly to the Investment Committee on a quarterly basis, in accordance with the terms of its contract.

E.D. Special Pproject Gconsultants may be hired to provide specific advice concerning various issues pertaining to the implementation of the Program. These issues include the following issues:

1. Investment research on topical issues;
2. Investment policy;
3. External Manager research; and,
4. Performance measurement and analysis.

Consultants may also be used to monitor and report organizational changes at investment firms.

#### **IV. PERFORMANCE OBJECTIVE AND BENCHMARK**

Specific performance objectives and benchmarks for each externally managed program are outlined in policy and External Manager guidelines.

#### **V. INVESTMENT APPROACHES AND PARAMETERS**

Specific investment approaches and parameters for each externally managed program are outlined in policy.

##### **IV.A. EXTERNAL MANAGER EVALUATION**

A.1. The ongoing evaluation of external investment managers includes both qualitative and quantitative reviews of the firms. Qualitative monitoring involves reviewing the following organizational aspects:

- 1.a. Ownership;
- 2.b. Staffing;
- 3.c. Growth;
- 4.d. Client service;
- 5.e. Investment approach;

6.f. Business risk; and

7.g. Regulatory issues.

B.2. Quantitative monitoring requires analysis of the implementation of the investment approach:

1.a. Investment style,

2.b. Performance; and

3.c. Portfolio risk.

Staff shall develop and maintain specific watchlist criteria detailing the qualitative and quantitative factors to evaluate External ~~m~~Managers.

As determined by Staff through its evaluation and monitoring of External ~~m~~Managers if significant events occur which will likely affect long-term overall performance, the External ~~m~~Manager shall be placed on Watchlist Status or considered for Dismissal.

**Watchlist Status** - Indicates a level of concern which shall be unique to each situation and quantified by Staff to the Investment Committee. This level of concern can range from minor to major deficiencies. A recommendation for Watchlist Status shall consist of ~~designate~~ a period of time to assess the capabilities and quality of an external ~~M~~manager's operations and include more frequent contact with the firm to monitor the conditions that led to the Watchlist Status. External ~~M~~managers placed on Watchlist Status shall be requested to submit a Plan of Action to address the deficiencies and shall typically remain on Watchlist Status for performance-related issues or organizational changes for up to one year to ensure that outstanding issues are resolved. External ~~M~~managers who do not correct outstanding issues in a timely manner shall be considered for Dismissal.

**Dismissal** - Staff shall ~~proceed~~recommend with Dismissal of an External ~~m~~Manager if adequate improvement in the areas outlined in the Plan of Action has not been made; however, Staff may recommend Dismissal for any reason upon thirty days' notice to the External ~~m~~Manager.

Staff shall keep the Committee fully informed of all situations where an External Manager may be dismissed, including concerns about performance, key personnel changes, organization changes or legal issues.

From time-to-time, external ~~M~~managers may not incur Watchlist Status (because performance slightly exceeds the benchmark), but may not have

met their performance objective (expected excess return over the benchmark) as specified in their Investment Management Guidelines. In cases where the benchmark return is surpassed, but expected excess return has not been earned during a significant period of time (three years), Staff may place the firm on ~~recommend~~ Watchlist Status.

## **VI. CALCULATIONS AND COMPUTATIONS**

Not applicable

## **V. GLOSSARY OF TERMS**

~~Definitions for k~~Key words used in this policy are defined ~~located in the Equity Glossary of Terms which is included in CalPERS' the System's Master Glossary of Terms.~~

Approved by the Policy Subcommittee: August 11, 1999  
Adopted by the Investment Committee: October 18, 1999  
Revised by the Policy Subcommittee: October 6, 2000  
Adopted by the Investment Committee: November 13, 2000  
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Adopted by the Investment Committee: February 14, 2005

Name Change to Monitoring Externally Managed Portfolios  
Revised by the Policy Subcommittee: March 17, 2008

Asset Class Glossary: Equities  
Policy: ~~Manager-Monitoring~~ –Externally Managed Portfolios  
March 17, 2008

**Dismissal**

Termination of the investment management contract with CalPERS, by requesting that the external investment manager resign or recommending contract termination to the Investment Committee.

**External Manager**

An asset management firm retained by CalPERS to manage a portfolio of securities for a fee. The external manager usually has full discretion to manage CalPERS' assets, consistent with investment management guidelines provided by CalPERS and fiduciary responsibility. A professional responsible for managing the securities portfolio of an individual or institutional investor. In return for a fee, the money manager has the fiduciary responsibility to choose and manage investments prudently for their clients. In the System's case, an internal manager is a portfolio manager on the staff, while an external manager is an outside money management firm.

**Limited Liability Company**

An alternative structure to a Limited Partnership. It is often described as a hybrid between a corporation and a partnership because it offers limited liability like a corporation and single taxation on income like a partnership.

**Limited Partnership:**

The most common format used in structuring private equity investments. Limited partners provide the capital but have no direct involvement in the management of the fund. Limited partners have limited liability but also have limited control over the management of the fund.

**Watchlist Status**

Indicates a level of concern, the degree of which shall be unique to each situation with the parameters specified in the relevant policy.